

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Territory Director, Northeast Area
(Examination, PSP)

from: Audrey Ellis, Senior Counsel, Branch 1
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice may not be used or cited as precedent.

LEGEND

Trust =

Decedent =

Charities

State =

D1 =

D2 =

D3 =

Date =

a% =

b% =

c% =

k =

ISSUE

Is Trust entitled to an income tax deduction under § 642(c)(1) for payments made to the Charities?

CONCLUSION

Trust is not entitled to an income tax deduction under § 642(c)(1) for the payments made to the Charities because the payments were not made pursuant to the governing instrument.

FACTS

Decedent died on D1. Decedent left a last will and testament which established Trust. At the time of Decedent's death, Decedent owned an individual retirement account (IRA), of which the designated beneficiary was Trust. Trust's only asset was the IRA.

Article SECOND, paragraph (b) of Trust provided that the trustee shall transfer and pay over a% of the Trust property over to the beneficiaries of Trust annually on Date in the following shares: b% to each of Decedent's six children, and c% to each of the Charities.

Additionally, Trust contains no termination date, and does not specifically provide for the disposition of a child's b% share of the a% distribution if a child dies during the existence of Trust. Trust does not provide for any modification of the annual payments by the trustee.

On D2, Trust was reformed by a court order in State. The court order modified the interests of the Charities and the Decedent's six children. The purpose of the reformation was to ensure that the Trust would meet the regulatory definition of a designated beneficiary trust under § 401(a)(9) and the regulations thereunder.

Article SECOND, paragraph (b) of reformed Trust provides that the trustee shall transfer and pay over c% of the value of Trust outright to each of the Charities no later than D3. Trust distributed c% of Trust corpus to each of the Charities prior to D3.

Additionally, Article SECOND, paragraph (c) of reformed Trust provides that the balance of Trust corpus will be held in six separate shares, one for each of Decedent's children. Each child is entitled to an a% annual unitrust interest from his or her respective separate share, with the corpus of each separate share to be distributed outright to the respective beneficiary when he or she attains age k.

LAW AND ANALYSIS

Section 642(c)(1) provides that in the case of an estate or trust there shall be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c).

Section 1.642(c)-1(a)(1) provides that any part of the gross income of a trust which, pursuant to the terms of the governing instrument, is paid during a taxable year for a charitable purpose shall be allowed as a deduction to the trust.

In Crown Income Charitable Fund v. Commissioner, 8 F.3d 571, 573 (7th Cir. 1993), aff'd 98 T.C. 327 (1992), the Seventh Circuit addressed the issue of commutation. The trust at issue in Crown Income Charitable Fund contained a provision permitting the trustees to commute the charitable interest only if, as a matter of law, it was clear that doing so would not adversely affect the maximum charitable deduction otherwise available. The trustees of the Crown Income Charitable Fund distributed trust assets in excess of the annuity amount to the charitable beneficiary over a number of years and deducted, under § 642(c), the full amount distributed to the charitable beneficiaries. Both the Seventh Circuit and the Tax Court held that the excess distributions were not deductible under § 642(c) because those instruments were not made pursuant to the terms of the governing instrument.

In Brownstone v. United States, 465 F.3d 525 (2nd Cir. 2006), a deceased husband's will created a marital deduction trust, which granted the husband's surviving wife a general testamentary power of appointment. When the wife died, she exercised her power in favor of her estate, the residue of which passed to charitable organizations. The trustee of the marital deduction trust distributed \$1 million to the wife's estate and claimed a charitable contribution deduction under § 642(c), because the \$1 million distribution passed entirely to the charitable beneficiaries under the wife's will.

The Second Circuit in Brownstone held that the distribution to the charities was made pursuant to the wife's power of appointment and not pursuant to the governing instrument, the deceased husband's will. The Second Circuit interpreted the definition of governing instrument narrowly, stating that an instrument subject to the creating instrument (the wife's will) could not combine with the creating instrument (the husband's will) and qualify as the governing instrument. The sole governing instrument in Brownstone is the husband's original will; therefore, the marital deduction trust is not

entitled to a deduction under § 642(c) since the distribution was made pursuant to the wife's will.

In Lyeth v. Hoey, 305 U.S. 188 (1938), the Supreme Court held that property received in the settlement of a bona fide will contest is treated for federal income tax purposes as passing to the beneficiaries by inheritance.

In Middleton v. United States, 99 F.Supp. 801 (D.C. Pa. 1951), the court held, applying principles derived from Lyeth, that amounts distributed to a charity pursuant to an agreement compromising a will contest were made "pursuant to the terms of the will." The court concluded that the income from the property that was distributed to the charity was permanently set aside for a charitable purpose and allowed a deduction for these amounts for the years prior to the year that the parties entered into the settlement agreement. See also Estate of Wright v. United States, 677 F.2d 53 (9th Cir. 1982), cert. Denied, 459 U.S. 909 (1982); Emanuelson v. United States, 159 F.Supp. 34 (D.C. Conn. 1958).

In Emanuelson, decedent left two conflicting wills – one which left 2/3 of the residue of decedent's estate to certain charities, and another which left the entire residue to non-charitable legatees. After decedent's death, a controversy arose among the beneficiaries of the two wills. The controversy was resolved in a written compromise agreement between the two sets of beneficiaries, under which 52/480 of the residue passed to the charities named in one of the wills. Payments made to the charities under the written compromise agreement were held to be made pursuant to the will.

Rev. Rul. 59-15, 1959-1 C.B. 164, citing Emanuelson, held that a settlement agreement arising from a will contest qualifies as a governing instrument.

In this case, there was no conflict with respect to Trust. In both the original Trust and in the modified Trust, the Charities are entitled to c% of Trust property each. The purpose of the court order was not to resolve a conflict in the Trust; it was to obtain the tax benefits that would ensue if Trust were to qualify as a designated beneficiary trust under § 401(a)(9) and the regulations thereunder. Neither Rev. Rul. 59-15 nor Emanuelson hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict. Additionally, both Crown Income Charitable Fund and Brownstone have a narrow interpretation of what qualifies as pursuant to a governing instrument. Therefore, the accelerated payments to the four Charities are not considered to be made pursuant to the governing instrument, and Trust is not entitled to a deduction for such payments under § 642(c).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



[REDACTED]

[REDACTED]

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Please call Steven Schmoll of this office at (202) 622-3050 if you have any further questions.